



**Committee On State Taxation**  
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**Re: MTC Public Participation Working Group Project Addressing Sales and Use Nexus  
Guidelines for Remote Sellers**

Dear Merle and Mike:

This letter is submitted to you both in your capacities as co-chairs of the above-referenced project, and represents the observations and suggestions of the Committee On State Taxation concerning the goals of the Project and the manner in which those will be pursued. I will be attending the meeting of this Public Participation Working Group (the "Working Group") in Dallas, June 16-17th, and will be happy to present the views of COST to the other participants in the Working Group at that time. However, in order to assist you in planning the first working session, this letter is being sent two weeks in advance of the meeting.

### **GOALS AND THE "PHILOSOPHY" OF THIS PROJECT**

The members of a specially designated COST task force have been studying and reacting to various drafts of the "Constitutional Nexus Guideline for Application of a State's Sales and Use Tax to an Out-of-State Business" for close to two years. During that time, COST prepared several draft responses to the MTC concerning the general concept and specific contents of its draft proposed nexus guidelines. Merle Buff and I personally met with Paul Mines, MTC General Counsel, concerning the second set of draft proposed guidelines, on April 15, 1996, and at that meeting we shared with the MTC an outline of our comments on the draft proposed guidelines.

We strongly urged the MTC to take a different tack in addressing the obvious nexus problems/questions that confront both state tax administrators and taxpayers, which would focus on jointly finding practical — thus, generally procedurally oriented — solutions to the intractable nexus debates and the uncertainty that has hampered efficient sales and use tax administration and compliance

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efforts, even after *Quill*. We stressed that because taxpayers understand *Quill* to provide a greater level of protection than the MTC apparently has been willing to concede, and since state courts after *Quill* have appeared to assume some level of actual physical presence as a prerequisite to establishing "substantial nexus," the substantive nexus standards proposed by the draft guidelines would never be accepted by taxpayers. However, we also noted that the MTC's interest in providing more certainty and uniformity in this area was truly laudable, and a real possibility existed for taxpayers to work with the MTC on a different approach to providing certainty and ease of compliance. An agreement that embodied these features would incentivize taxpayers to volunteer to collect and remit use taxes on interstate sales, which are clearly due, which have *not* been collected by the states from their residents, and which is the real concern of states and the MTC underlying the draft proposed guidelines.

It is clear that part of this message was heard by the MTC. It has actively engaged in work on the EDI and Audit Legal Issues Steering Committee, it invited Ms. Buff to speak on procedural measures that might improve sales tax administration at its last Annual Meeting, and it announced its intention to sponsor a Simplification of Sales Taxation project, focusing on practical/procedural measures. Unfortunately, the draft proposed nexus guidelines continue to focus solely on substantive, allegedly "constitutional" nexus guidelines.

We are concerned that an approach that keys off of the draft proposed guidelines will be viewed by some participants as so prejudicial that the process will be doomed to failure. Whether a solution to our existing sales and use tax nexus crisis is pursued in the context of an MTC Public Participation Working Group, or in the context of the typical MTC Uniformity Committee process, these efforts must reflect the true underlying goals of both parties at the table, if there is to be any hope of reaching a practical, workable, and enforceable solution. The draft proposed guidelines do not satisfy the above-mentioned goals of either the States or state taxpayers, nor will they engender the bipartisan support necessary to justify their issuance -- even if the participants in the Working Group could contort them into a mutually acceptable recommendation.

#### PROPOSED ALTERNATIVE APPROACH FOR THE WORKING GROUP

It was encouraging to hear Alan Friedman, Special Counsel to the MTC, suggest that the Working Group examine the product of negotiations between the Direct Marketing Association ("DMA") and several states and with the Federation of Tax Administrators (we understand that the MTC is also present, in an advisory capacity). Like the task being undertaken by the Working Group, the task before the DMA was to define circumstances under which the taxpayers most directly involved in making interstate sales would be enabled by the states to voluntarily register and collect/remit use taxes. In fact, the original title of the draft guidelines referenced nexus for "remote sellers," which would certainly encompass the members of the DMA. True, the original goal of the DMA negotiations was to define nexus more clearly, by reference to a set of activities and contacts that would/would not qualify for protection from registration requirements; then, the negotiations would provide certain benefits to protected vendors that chose to register and collect use taxes. However, because that line of endeavor failed to produce anything of use, the negotiations were refocused. Today, the DMA's tentative letter of

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intent for registration for limited contacts marketers focuses on practical issues that are susceptible of joint resolution, and appears to settle a large area of controversy.

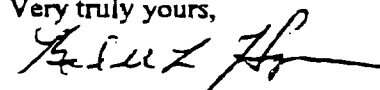
COST suggests that the goals and approach of the Working Group be similarly refocused. The immediate goal of the Working Group should be to create a set of rules that both incentivizes taxpayers to voluntarily register to collect and remit use taxes on a prospective basis, and closes the audit potential for back tax periods. Many measures have been suggested previously; now, we as a group must take an "anything goes" approach to meet this goal. In that vein, consideration might be given to:

- All "incentives" provided to the members of DMA who execute the letter of intent for registration of limited contacts marketers. [As a matter of equity, taxpayers that are similarly situated will demand the right to file such a letter of intent. Let's clarify that the letter is applicable to all taxpayers.] Such incentives include prospective-only liability for uncollected use taxes, and a safe harbor for compliance with state and local use tax provisions.
- Compensation, in a form which will allow limited contacts marketers/vendors that voluntarily register to cover their costs associated with filing saels and use tax returns at the state and local level. Compensation might take the form of a credit or an administrative discount.
- Offering alternatives to limited contacts or disputed contacts vendors, e.g., registration under the finally negotiated set of conditions, or provision of complete lists of in-state purchasers, with adequate information to permit the taxing jurisdiction to institute action (itself, or through a contractual arrangement) to collect the use taxes due from the in-state resident.

An additional fact needs to be underscored. Taxpayers carry different risk profiles, and will view whatever the Working Group produces as only one of their available options. Some taxpayers will prefer to assert that current nexus standards and jurisprudence afford them protection from the requirement to register and collect use taxes. However, by making another *real* option available to taxpayers other than the 100% victory-or-loss option (as both states and taxpayers view this scenario), we promote the mutual accommodations that characterize a successful tax system which is reliant on self-compliance/reporting. If we do *not* alter our approach to the nexus issue, then COST believes this project will, ironically enough, push both sides back into court -- as neither party can effectively define "constitutional" nexus standards.

If you have any questions, please call me.

Very truly yours,



Kendall L. Houghton

cc: Charles W. Drury, Jr., Chair  
J. William McArthur, Jr., Esq., President & Executive Director  
Douglas L. Lindholm, Esq., Legislative Director  
Jeffrey A. Friedman, Tax Counsel